

Mr. Chairman and Members of the Senate Finance Committee, we appreciate the opportunity to discuss the present lumber trade dispute between the United States and Canada. My name is Rodger Schlickeisen, and I am president of Defenders of Wildlife, a non-profit biodiversity advocacy organization with over 1,000,000 members and supporters in North America.

I. Overview and Summary

It is not everyday that we are in agreement with the U.S. timber industry, but today we stand together on one fundamental issue: *that the Canadian timber industry is massively subsidized by both the federal Canadian government and the various provincial governments.* These illegal subsidies not only harm the U.S. timber industry, but also inflict significant and major injuries to American and transboundary habitats, as well as harm to forests in Canada that are of continental and global significance. Only by understanding the full nature of these present subsidies can we move forward with durable solutions to this longstanding dispute between two nations that are otherwise friendly neighbors and close allies.

This testimony is not only endorsed by our principal U.S. environmental allies in this effort, such as NRDC and the Northwest Ecosystem Alliance, but also supported by many environmental and citizens' groups on both sides of the border, who realize that fundamental forestry reform in Canada must be addressed in the current softwood lumber negotiations.¹ We do not oppose continued logging in Canada, nor do we oppose trade in softwood lumber. What we oppose is the literal liquidation of all wild forests in Canada in a manner that is economically unsustainable, ecologically destructive, and highly distortive of truly free trade.² *Any meaningful solution to the present impasse, consequently, must be grounded in the reality that "the market" is not working with regard to Canadian lumber.*

While my counterpart from the Coalition for Fair Lumber Imports (CFLI) will address some of the subsidies granted to the Canadian timber industry -- for example, the administratively set and exorbitantly discounted stumpage fees charged to Canadian timber companies to actually cut down trees -- I'd like to focus my limited time this afternoon on the intertwined subsidy issues of *tenure monopolization* and *weak environmental protection*. That is, because the Canadian timber industry is dominated by a relatively small number of

¹ It is imperative to contextualize the "grassroots groups" supposedly opposed to curbs on Canadian timber exports to the United States. First, some of these groups, such as the American Consumers for Affordable Housing, are funded by the Canadian timber industry. Second, wood is less than 3% of the total cost of a new house, and even this cost can be significantly lessened (to levels approaching zero) by wood efficiency methods touted by the National Association of Homebuilders (NAHB) itself.

² For these reasons, Defenders and our allies have been preparing a "Citizens' Trade Alternative" to aid negotiations of a new softwood lumber agreement. This draft document serves to help the U.S. negotiators by providing a legal framework under the National Environmental Policy Act, the Endangered Species Act, and relevant international law.

companies, who receive free and virtually unfettered long-term access to forested areas, the governments of Canada are either unable or unwilling to meaningfully regulate the Canadian industry's behavior. In addition, we do not see how the significant stumpage price disparity between the two countries can be rectified without examining reforms in the Canadian tenure system, which helps shield Canadian timber companies from the competitive and open markets. Subsidies based on weak environmental regimes are discussed immediately below.

II. The Clear Linkage Between Harmful Trade Subsidies and Environmental Degradation

From the perspective of science-based environmental protection of shared forest ecosystems, an end to the harmful subsidies now granted to the Canadian industry would unequivocally aid the protection of imperilled species and habitats. "Regulatory relief" to Canada's timber industry, secured either from weak environmental standards or from lack of environmental enforcement, clearly serves as a financial "pass back" to the Canadian industry.³ Thus, if the Canadian timber industry cannot make profits based upon artificially low stumpage fees, then the provincial governments will once again reduce environmental protection standards to lower costs.

To the Canadian timber industry's bottom-line, there simply is no difference between these "lack of environmental protection" subsidies and other economic subsidies.⁴ Estimates of the *total amount of harmful subsidies from weaker environmental protections* granted to the Canadian timber industry total *at least hundreds of millions of dollars annually*. Recent proposed "result-based" changes by the existing B.C. Government to the B.C. Forest Practices Code could significantly increase these subsidies. See Attachment 1 from Vancouver Sun, 25 October, 2001 ("Victoria takes axe to FRBC, prepares to 'streamline' Forest Practices Code; Goal is to trim delivery costs").

In order to get a handle on the magnitude of the environmental lawlessness and the concomitant damage occurring in Canadian forests, at least three types of harmful subsidies from weak environmental protection must be identified:

- Subsidies granted by the provincial governments for lax and poorly enforced

³ The 1996 U.S.-Canada SWLA at Article VII explicitly recognized "forest management systems" highly relevant to subsidy determinations, and in 1998, the B.C. Government justified its unilateral reduction in stumpage fees as necessary to offset forest management costs.

⁴ See generally Tom Green and Lisa Matthaus, *Cutting Subsidies or Subsidized Cutting?* (July 12, 2001) at 12-15. Although this report commissioned by the B.C. Coalition for Sustainable Forestry Solutions focuses on British Columbia, where many independent analysts have reached similar conclusions, the problems discussed are rampant throughout other provinces such as Alberta, Quebec, and Ontario. Further information on the other provinces can be supplied, upon request.

forest practices codes. Issues here include the lack of meaningful environmental assessments, mandatory high-cut levels with over-reliance on large clear-cuts, lack of riparian habitat protection, and non-existence of binding ecological indicators on logging and disturbance actions. By way of comparison, the provincial forestry codes in Canada are far weaker than the standards in the U.S. National Forest Management Act.

- Subsidies granted by the federal government and certain provincial governments such as Alberta and British Columbia by failing to possess an Endangered Species Act (ESA). Indeed, the current federal legislative proposal supported by the ruling party of Prime Minister Chretien does not contain any mandatory habitat protections, even on federal lands in Canada. This discrepancy greatly harms U.S. ecological interests, and puts the U.S. timber industry at a distinct competitive disadvantage.
- Subsidies granted by the federal government for failure to enforce the federal Fisheries Act, which requires protection of riparian habitat. Last year, the Natural Resources Defense Council, along with Defenders and the Northwest Ecosystem Alliance, calculated that this subsidy gave the timber industry in British Columbia over \$243 million (CND) annually in savings.

Despite these severe problems, which are harming U.S. workers⁵ and U.S. listed species such as the grizzly bear, woodland caribou, bull trout, lynx and marbled murrelet, *there are viable solutions in sight*. Step one in reaching a solution, however, entails the two countries firmly acknowledging the critical connections between forest management practices and fair trade. Once this point is reached, the formula for successful negotiation will likely involve a sliding scale system of compensatory duties that decrease over time as reforms in Canada are verified by an independent binational body. *If the linkage between environmental protection and harmful trade subsidies is not made in the framework for future negotiations, any agreement reached will not be durable or long-lasting because of the Canadian industry's ability to recoup costs through poor ecological stewardship.*⁶

III. Subsidies Granted to the Canadian Timber Industry

Three core categories of subsidies have a major impact on binational forest protection: 1) stumpage fees, 2) tenure system issues, and 3) environmental compliance problems.

⁵ See, e.g., Testimony of G. Bruce Willis, The United Brotherhood of Carpenters and Joiners of America, Senate Field Hearing on Canadian Lumber Imports (July 1, 2001).

⁶ The provincial government of Quebec should be noted for its proposal to link the economic trade issues with the environmental trade issues.

A. Pricing (Stumpage)

In the United States, the vast majority of timber on both public and private lands alike is sold in competitive markets. In Canada, the forested land is primarily owned by the province and the timber is sold to a handful of large timber companies far below market value through long-term tenures. In fact, ninety-five percent of the land in British Columbia, by far the largest exporter of softwood lumber in Canada (CNS\$ 6.88 billion in 2000), is owned by the province.⁷ As a subsidy to the Canadian timber industry, stumpage fees are administratively set one-third to one-quarter of the true market price.⁸ These low stumpage rates are “based on government’s revenue objectives rather than an accurate assessment of what the timber would be worth in a well-functioning market situation.”⁹ Estimated subsidies to the BC timber industry for one year, 1999-2000, ranged from C\$2.8 billion to C\$3.6 billion.¹⁰

One technique called ‘grade-setting’ allows the logging companies to successfully manipulate the stumpage system by circumventing higher-end stumpage rates. By unloading the worst quality wood from the cutblock first, a low stumpage rate assessment is triggered for all the wood, even though higher-grade logs are removed later. Researchers at The Sierra Legal Defense Fund estimated that coastal companies in British Columbia saved C\$138 million between 1998 and 2000.¹¹ In response to all these problems, a number of government commissioned blue-ribbon panels have recommended the creation of competitive and transparent regional log markets, with sufficient participation to prevent price manipulation.

B. Tenure System

Through long-term tenure (or license) agreements, the provincial governments provide logging companies security of access to a specified timber supply, free of charge. In exchange, tenure agreements require companies to process the wood at particular mills (with the intention of providing employment and community stability) in addition to paying stumpage. However, the BC government has been permitting more and more timber companies to shut down

⁷ Environment Canada. *The State of Canada’s Forests 2001: Profiles Across a Nation*. (http://www.nrcan-rncan.gc.ca/cfs-scf/national/what-quoi/sof/sof01/profiles_e.html#CND)

⁸ The New America Foundation, *Stopping the Giveaway of Canada’s Forests: Establishing True Free Trade in Softwood Lumber* (October 2000) at 11.

⁹ Green and Matthaus at 5.

¹⁰ *Id.* at 8.

¹¹ Mitch Anderson and John Werring, *Stumpage Sellout: How forest company abuse of the stumpage system is costing B.C. taxpayers millions* (Vancouver: Sierra Legal Defense Fund, 2001).

appurtenant mills, but nonetheless to retain control over their licensed wood supply.¹²

Fourteen large companies control a full two-thirds of the provincial wood supply in BC. While the government provides enormous tenures coupled with an almost automatic license renewal, competition is non-existent. Overall in Canada, thirteen timber companies possess tenures each as large as all of Switzerland, accounting for roughly half of Canada's total forest tenures.¹³ The present tenure system does not promote fair competition or good land stewardship. Tenure take-back and redistribution have been recommended by a wide variety of Canadian stakeholders.

C. Forest Management and Environmental Protection

As discussed in the overview and summary, *supra*, the Canadian timber industry operates under weak and poorly enforced environmental protections. At present, there is no accepted binational mechanism in place to gauge the effectiveness of Canadian forest-related environmental laws, or their level of enforcement. Because it is obvious that environmental compliance is an area targeted by the Canadian timber industry for "pass backs," weak and/or poorly enforced ecological standards must not become a way in which a new binational agreement is circumvented.¹⁴ The *linkage* between harmful trade subsidies and environmental degradation must be maintained in any future softwood lumber negotiations. *This central issue cannot be emphasized enough.*

IV. The Overcutting of Canada's Forests

¹² Green and Matthauss at 21-22.

¹³ Global Forest Watch Canada, *Canada's Forests at a Crossroads* (World Resources Institute, 2000) at 71.

¹⁴ See Attachment 1 from October 2001 *Vancouver Sun*, which calls forest management system "cost-burdensome." More recently, the ruling provincial government of B.C. announced major budget cuts that will severely hamper natural resource management and enforcement. Environmental groups from both countries have informed USTR and the rest of the U.S. administration of these recent developments. Numerous independent studies have documented the costs savings associated with shirking basic environmental responsibilities. See, e.g., PricewaterhouseCoopers, *The B.C. Forest Industry: Unrealized Potential* (January 2000) at 3-4; British Columbia Ministry of Forests, *Financial State of the Forest Industry and Delivered Cost Drivers* (April 1997), available at www.for.gov.bc.ca/het/costs/fin-10.htm. In addition, enforcement audits by the Northwest Ecosystem Alliance indicate that over 50% of examined forest planning units in Canada possessed significant environmental enforcement problems. See also David R. Boyd, *Canada vs. The OECD: An Environmental Comparison* (University of Victoria, 2001)(detailing Canada's woeful environmental enforcement record generally).

Without the subsidies, many of Canada's forests would simply be uneconomic to log. Wood priced well below market value -- sometimes offered to the Canadian industry for as low as \$10 for a full truck load or .25 (one quarter) for a cubic meter -- provides a perverse incentive to cut more trees. As logging companies move to expand timber production, primary growth forests are increasingly harvested in response to the bevy of subsidies available to the companies. In fact, more than 90 percent of timber harvested in Canada comes from old-growth forests.¹⁵ Throughout all of Canada, logging companies are harvesting wood at a rate 25% above *sustainable economic levels*, while in B.C. that number moves to 40%.¹⁶ Weak or no provincial endangered species acts encourage logging in the habitat of endangered and threatened species such as the woodland caribou and the grizzly bear, undermining millions of U.S. dollars spent every year under the ESA to protect these fragile species.¹⁷ Tenure agreements that mandate minimum cut levels exacerbate this problem. As the Bush I Commerce Department aptly stated:

The extensive margin means that, at any particular stumpage price, only certain categories of stands can be profitably harvested. As the price of stumpage drops, more and more stands become economically accessible, which allows the supply of stumpage to increase. The intensive margin concept applies to trees within a stand that is currently economically accessible. It recognizes that, within each stand, there are certain categories of trees that cannot be profitably harvested at a given stumpage price. If stumpage prices are lowered, the intensive margin is expanded so that the formerly unutilizable trees within a particular stand can be profitably harvested, thereby increasing the supply of timber.

57 Fed. Reg. 22570, 22589 (May 28, 1992).

V. U.S. Homebuilders' Perspective

The National Association of Homebuilders (NAHB) claims that tariffs on Canadian softwood lumber increase the cost of building a home. However, they fail to mention: 1) lumber prices are now at near record lows because of abundant supply; 2) lumber represents less than 3% of the price of an average home.¹⁸ Further, using wood efficiency practices recommended by NAHB's own research center -- such as trusses and panels, stressed-skin panels, and optimum value engineering -- can reduce building costs by as much as \$4,800 per home, sometimes easily

¹⁵ Global Forest Watch Canada, *Canada's Forests at a Crossroads* (World Resources Institute, 2000) at 55.

¹⁶ Id.

¹⁷ U.S. Fish and Wildlife Service. *Summary of the Conservation Status of Selected Forest-Related Species with US/Canada Ranges* (January, 2001).

¹⁸ The New America Foundation at 37.

making up the cost of fairly priced wood products from Canada.¹⁹ And, again, it must be remembered that our coalition does not seek to end Canadian timber exports to the United States.²⁰ We seek only a more rational economic and ecological framework under which Canadian logging takes place.

VI. Constructive Solutions to the Softwood Lumber Debate

We support a negotiated settlement to the softwood lumber trade dispute as the most efficient avenue for broad provincial forest management reforms and we hope that our comments can be of assistance in reaching a durable agreement. Any negotiating framework settled on by our two countries needs to be comprehensive. We have pointed out many times in the past months that the fundamental elements of a softwood lumber trade agreement are interdependent. No one will benefit if reforms are only partially implemented. We believe that a durable solution is only possible under a strong framework that ties the core elements together as a single package. These core elements include tenure reallocation, full market pricing, improved environmental measures, and recognition of aboriginal title.

Environmental organizations advocate a solution to the softwood lumber dispute that addresses the economic, environmental and social problems related to forestry in Canada. The following reforms would not only solve the softwood lumber dispute, but also lead to a more innovative, ecologically sound and publicly beneficial forest sector by: diversifying control over forest lands, creating opportunities for new market entrants, ensuring full value for the forest resource, and ensuring greater public participation and environmental protection in our forests.

A. Diversify control over forest lands in Canada

In many areas of Canada, a relatively small group of integrated forest products companies control the vast majority of the land base through long-term licenses or “tenures.” This has implications for Canada as well as the United States. Because the economies of many communities are dependent on them, these companies are able to pressure governments to ease environmental protections and reduce the amount they pay for trees. The tenure system has undermined the capacity of forest-based communities to achieve ecological sustainability, economic diversity and control over land-use decisions that will affect their lives, while presenting an obstacle to the honorable resolution of aboriginal land issues.

¹⁹ See www.nrdc.org for NRDC publication *Efficient Wood Use in Residential Construction: A Practical Guide to Saving Wood, Money and Forests* (1998) (Attachment 2).

²⁰ Indeed, under the 1996 SWLA, which allowed all Canadian softwood lumber up to 14.7 billion board feet per year into the U.S. duty-free, Canadian exports regularly exceeded the amount of lumber that triggered the highest sliding scale duty (i.e., \$100/thousand board feet), indicating a viable market exists for such higher-priced wood.

Recommendation: A significant portion of public forest tenures must be taken back to break up timber monopolies and to facilitate increased conservation, resolving First Nations land issues and providing tenure to a diversity of new entrants, such as small business loggers, woodlots and community forests.

B. Ensure full market value for timber resource

Although the vast majority of provincial forested land is publicly owned, Canadians do not receive the full economic rent under current stumpage policies. Provincial stumpage systems are often arbitrary, subject to manipulation by licensees and governments, and inadequately monitored or enforced. These shortcomings result in subsidies to licensees estimated in the billions of dollars. These subsidies encourage unsustainable over-cutting and result in negative impacts on transboundary and endangered wildlife. While increasing the number of timber sales for small business loggers can play a role in establishing a fair market value for public timber, it is very important to create *actual* markets in logs for processing. Even if a range of loggers can participate in the market for harvesting rights, if these loggers can only sell their logs to a few large processors, Canadian wood product markets will remain artificially restricted to low-end goods.

Recommendation: Provinces must institute regional log markets to generate accurate timber values, ensure ease of access to wood for all wood processors (particularly in the value-added sector), and provide confidence that the full value of logs is being collected.

Recommendation: Sufficient volume must be required to flow through log markets to ensure truly competitive bidding (e.g., 75% of timber harvested).

Recommendation: Stumpage fees must be calculated in a transparent manner, using accurate timber values from log markets and timber sales so that the full value of the wood is collected.

Part of ensuring full market value for timber resources requires an adequate field of players inside Canada to generate market signals. To this end, a softwood lumber trade agreement should leave existing raw log export bans in place. There are a variety of provincial and federal laws and policies that restrict the export of raw logs. The raw log export restrictions were intended to encourage value-added industries by discouraging large-scale export of the raw resource. Given the underdeveloped nature of Canada's value added industry, these restrictions must be maintained or strengthened to close present loopholes that undermine their effectiveness.

Recommendation: The raw log export ban must be maintained and the loopholes closed.

C. Implement improved environmental measures

Any negotiated settlement on the softwood issue must address the subsidy currently in place through Canada's weak forest management laws, including a lack of adequate protection for wildlife habitat and poor enforcement of rules that require protective buffers along the shores of Canadian waterways. While some provinces require habitat protection in their endangered species legislation, not all provinces have such legislation. The proposed federal *Species At Risk Act* fails to include this protection, despite Canada's obligations under international law and previous commitments to do so. Transboundary endangered species, including migratory birds, are afforded extensive protections under U.S. law, but are not adequately protected under Canadian law when they cross the border. Provincial rules also allow forestry companies to log in ecologically sensitive areas along the banks of fish-bearing streams. In B.C., for example, the *Forest Practices Code* offers no legally required protections for small fish-bearing streams and direct tributaries to fish-bearing streams, which are supposed to be protected under the federal *Fisheries Act*.

Recommendation: Any negotiated settlement must guarantee that no roll-back of federal or provincial environmental standards will take place.

Recommendation: The federal government must enforce the *Fisheries Act* to ensure adequate riparian protections, or at least ensure that provincial rules meet the standards of this Act.

Recommendation: The federal government must amend its proposed *Species At Risk Act* to ensure the habitat of all species at risk is protected.

D. Recognize Aboriginal Title

Forestry reforms can be lasting solutions only if they are based on a legally and morally defensible foundation -- recognition of Aboriginal Rights and Title. Failure to recognize this constitutionally enshrined right represents a further subsidy to the forest industry. Specifically, where government action infringes a nation's Aboriginal Title, there is a duty to consult in good faith, and in some cases consent is legally required. In addition, fair compensation will ordinarily be required when Aboriginal Title is infringed. Delgamuuk v. British Columbia, 3 S.C.R. 1010 (1997). Because of the constitutional requirements to address Aboriginal Rights and Title, any agreement that does not address these issues cannot be a long-term solution.

Recommendation: Aboriginal Title must be justly addressed as the underlying foundation for tenure and pricing reforms. These reforms must recognize the constitutionally mandated priority of aboriginal rights to forest resources after conservation concerns have been addressed, and revenue-sharing agreements that recognize the economic component of Aboriginal Title.

E. Next Steps

The United States and Canada are on the right path in discussing reforms of the pricing, tenure, and forest management. Only through such reforms can we achieve a durable solution to this dispute. However, once a framework for negotiation is settled upon, the hard work begins of ensuring that the framework will work in practice. For instance, on-the-ground forestry reforms must be monitored and verified. Such an implementation mechanism will need to include clear indicators of success to enable those monitoring implementation to evaluate the reform process. Furthermore, many of the reforms will take months and maybe years to complete. Cognizable interim reform steps, combined with reductions in the applicable duty or fee, should be actively considered. Of course, it is not acceptable to remove subsidies in one area, while granting new subsidies in another. Consequently, any implementation mechanism will need to establish safeguards against such backdoor subsidies, such as the weakening of environmental protections. Ultimately, *we believe serious consideration must be given to a bi-national commission to monitor reform, identify and analyze problem issues, and generally oversee implementation of a new softwood agreement.* This bi-national commission, or any other implementation mechanism, should function in an open and transparent fashion, including citizen representatives from both sides of the border.

VII. Broader Trade Principles At Stake

As might be expected, the softwood lumber issue is beginning to rear its head in multiple ways at international trade fora. The best way to curtail the continued proliferation of these types of actions is, of course, an appropriate negotiated settlement.

Last summer, for instance, Canada initiated case at the World Trade Organization (WTO) challenging the U.S. Department of Commerce preliminary countervailing duty determinations concerning softwood lumber from Canada. Canada alleges that the US Department of Commerce's preliminary determinations are inconsistent with WTO rules. Canada's position is that government-granted extractive rights to natural resources, in this case granted to Canadian timber companies for logging, cannot constitute a subsidy under international trade rules. The U.S. Government responded that the countervailing duty determinations were preliminary and subject to change, and that Canada's request for a panel was premature. The opening Canadian brief could be due as early as March 2002, coincidentally the month that the final determination by Commerce is due.

In December 2001, further, Canfor Corporation of British Columbia filed a case against the United States for \$250 million (US) in damages under Chapter 11 of NAFTA, which allows foreign corporations to sue national governments for democratic actions that merely reduce anticipated profits. Canfor alleges that the Commerce preliminary countervailing duty and anti-dumping determinations were made in an "arbitrary, discriminatory and capricious manner."

And just earlier this month, the North American Commission on Environmental Cooperation (CEC) announced that is formally seeking information for the preparation of a "factual record" as to whether Canada has failed to enforce the federal Fisheries Act in

connection with logging practices. The petition was filed by a binational coalition of environmental groups. At least one other complaint at the CEC concerning the federal government of Canada's failure to enforce the Fisheries Act is also pending.

The common denominator for all these actions is Canada's resistance to change "business as usual" in its lumber sector. Were it not for U.S. trade and environmental law, we would not possess the opportunity for change that now exists. But our window is short and narrow. We are hopeful that this Committee and the Administration can come up with a negotiating agenda that balances the binational diplomatic relationship, the lumber trade, and the extraordinary natural values in an effective way. *The upcoming Senate vote on the President's request for "trade negotiating authority" (or "fast-track") is a unique opportunity to revisit the U.S. trade agenda, with the tangible lessons of this softwood lumber debate firmly in mind.*

VIII. Conclusion

Thank you for the opportunity to provide testimony on this important international topic. If done correctly, a new U.S.-Canada softwood lumber agreement could set productive and historic precedents. We look forward to working toward this shared goal of a strong and effective negotiated settlement. If we cannot make the trade and environment linkages with a U.S.-Canada Softwood Lumber Agreement, we are hard-pressed to see where such linkages can be made. This is a very important test for the Bush Administration and its nascent trade policy.